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California Department of Justice

Attorneys for Complainant

**BEFORE THE  
CALIFORNIA BOARD OF ACCOUNTANCY  
DEPARTMENT OF CONSUMER AFFAIRS  
STATE OF CALIFORNIA**

In the Matter of the Accusation Against:

KPMG LLP  
355 South Grand Avenue, Suite 2000  
Los Angeles, CA 90071  
CPA Partnership Certificate No. PAR 157

Bryan E. Palbaum  
800 South Shamrock Avenue  
Monrovia, CA 91016  
Certified Public Accountant  
Certificate No. CPA 51655

John Ming Wong  
6252 Forester Drive  
Huntington Beach, CA 92648  
Certified Public Accountant  
Certificate No. CPA 45405

Kenneth B. Janeski  
355 So. Grand Avenue  
Los Angeles, CA 90071  
Certified Public Accountant  
Certificate No. CPA 20116

David Akio Hori  
400 E. Van Buren Street  
Phoenix, AZ 85004  
Certified Public Accountant  
Certificate No. CPA 68236

Roland William ("Bill") Carroll, Jr.  
540 San Geronio Street  
San Diego, CA 92106  
Certified Public Accountant  
Certificate No. CPA 14338,

Respondents.

Case Nos. AC-2005-13 (KPMG LLP);  
AC-2005-14 (Palbaum);  
AC-2005-15 (Wong);  
AC-2005-16 (Janeski);  
AC-2005-17 (Hori); and  
AC-2005-20 (Carroll)

**ACCUSATION**

Carol Sigmann, the Complainant herein, alleges:

1 **PARTIES and JURISDICTION**

2  
3 1. The Complainant herein, Carol Sigmann, brings this Accusation under Business  
4 and Professions Code Section 5100 solely in her official capacity as the Executive Officer of the  
5 California Board of Accountancy, Department of Consumer Affairs ("Board").

6 **License Information**

7 2. On or about February 10, 1949, the Board issued partnership certificate number  
8 PAR 157 to Peat Marwick Mitchell & Co. The Board approved two name change requests which  
9 resulted from mergers for certificate number PAR 157: on June 3, 1987, a name change was  
10 approved, to Peat Marwick Main & Co., and on June 1, 1990, a name change was approved, to  
11 KPMG Peat Marwick. Subsequently, on October 14, 1994, the Board approved a name change  
12 to KPMG Peat Marwick LLP to reflect its change in status to a "limited liability partnership." A  
13 subsequent name change to KPMG LLP<sup>1</sup> was approved, effective March 26, 1999. The certificate  
14 is in full force and effect and is renewed through February 28, 2007.

15 3. Prior Discipline. In a Board Decision and Order effective August 24, 2002,  
16 in its case No. 98-17, the Board disciplined the partnership license of KPMG LLP in relation to  
17 its (financial statement) audit engagements for Orange County in 1992 and 1993 and its  
18 (financial statement) audit engagement of the Orange County Transportation Authority in 1994.<sup>2</sup>  
19 The KPMG probationary order included a 30-day stayed suspension and a one-year probation on  
20 terms and conditions which are further summarized in the accompanying footnote.<sup>3</sup> The

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22  
23 1. "Respondent KPMG" or "KPMG" may be used herein to refer to KPMG LLP. The  
24 term "respondents" may refer to respondents in this case, or may refer to respondents in the  
SEC case referred to herein, e.g., in paragraph 22.

25 2. The CPA licenses of three individuals were disciplined in the same Board Decision and  
26 Order.

27 3. Firm probationary terms: Reimburse the Board's reasonable costs \$1,814,678.80;  
28 Payment of monetary (discovery) sanction of \$21,989; Practice investigation of its California  
practice in the area of audits of governmental agencies; Continuing education (government  
accounting and auditing) for KPMG staff at senior level and above; Experience requirements  
for auditors of governmental agencies; and other standard terms and conditions.

1 probationary period has been completed.<sup>4</sup>

2 4. On or about November 18, 1988, the Board issued Certified Public Accountant  
3 Certificate No. CPA 51655 to Bryan E. Palbaum ("Respondent Palbaum"). The certificate is  
4 renewed through February 28, 2007, and has not been the subject of prior Board discipline.

5 5. On or about May 2, 1986, the Board issued Certified Public Accountant  
6 Certificate No. CPA 45405 to John Ming Wong ("Respondent Wong"). The certificate is  
7 renewed through April 30, 2005, and has not been the subject of prior Board discipline.

8 6. On or about April 26, 1974, the Board issued Certified Public Accountant  
9 Certificate No. CPA 20116 to Kenneth B. Janeski ("Respondent Janeski"). The certificate is  
10 renewed through February 28, 2007, and has not been the subject of prior Board discipline.  
11 Respondent Janeski has also been licensed as a CPA in New York since 1981.

12 7. On or about January 20, 1995, the Board issued Certified Public Accountant  
13 Certificate No. CPA 68236 to David A. Hori ("Respondent Hori"). The certificate is renewed  
14 through November 30, 2006, and has not been the subject of prior Board discipline.

15 8. On or about January 24, 1969, the Board issued Certified Public Accountant  
16 Number 14338 to Roland William Carroll, Jr. ("Respondent Carroll"). The license is currently  
17 renewed in an inactive status through May 31, 2005, and has not been the subject of prior Board  
18 discipline.

19 9. The Respondents herein, including KPMG and the five individuals, will also be  
20 referred to herein as "KPMG's auditors" or "KPMG and its auditors."<sup>5</sup>

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23  
24 4. The Board's disciplinary order was not stayed during the appeals of its Decision. The  
25 Superior Court's decision denying the Petition for Writ of Mandate appealing the Board's  
26 Decision (*KPMG LLP et al vs Board of Accountancy*, BS077745, Superior Court of California,  
County of Los Angeles) was appealed to the California Court of Appeal (*KPMG LLP et al. v.*  
*The Board of Accountancy State of Calif.*, Case No. B170613, District 2) and the appeal is  
27 pending.

28 5. There may be other persons who took part in the audits who could be referred to as  
"KPMG auditors" but these persons are neither identified nor named in this or the Securities  
and Exchange Commission proceeding (see Paragraph 22).

## Statutes and Regulations

10. This Accusation is brought before the Board under the authority of Code Section 5100 of the Business and Professions Code,<sup>6</sup> which provides, in relevant part, that, after notice and hearing the Board may revoke, suspend or refuse to renew any permit or certificate granted,<sup>7</sup> for unprofessional conduct which includes, but is not limited to, one or any combination of the causes specified therein, including pertinent provisions of subparagraphs of Section 5100, as follows:

A. Suspension of the right to practice before a governmental body or agency [Bus. & Prof. Code § 5100(h)].

B. The imposition, by the United States Securities and Exchange Commission, of any discipline, penalty, or sanction on a registered public accounting firm or on any other holder of a permit, certificate, license, or other authority to practice in this state [Bus. & Prof. Code § 5100(l)].

C. The willful violation of this chapter or any rule or regulation promulgated by the Board under the authority granted under the Accountancy Act [Bus. & Prof. Code § 5100(g)].

11. Code Section 5062 requires a licensee to issue a report which conforms to professional standards upon completion of an audit of financial statements [Bus. & Prof. Code § 5062].

12. Code Section 5101 provides, *inter alia*, that a partnership permit may be disciplined for any of the causes enumerated in Code Section 5100.

13. Board Rule 58 (Title 16, Cal. Code Regs., § 58) provides that licensees engaged in the practice of public accountancy shall comply with all applicable professional standards,

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6. All statutory references are to the Business and Professions Code unless otherwise indicated.

7. Code Sections 118(b) and 5109 provide in pertinent part that the suspension, expiration, cancellation, or forfeiture of a license issued by the Board shall not, deprive the Board of its authority to investigate, or to institute or continue a disciplinary proceeding against, a licensee upon any ground provided by law, or to enter an order suspending or revoking the license or otherwise taking disciplinary action against the licensee on any such ground.

1 including but not limited to generally accepted accounting principles and generally accepted  
2 auditing standards.

3 14. Section 5107(a) of the Code provides in pertinent part that the Executive Officer  
4 of the Board may request the administrative law judge, as part of the proposed decision in a  
5 disciplinary proceeding, to direct any holder of a permit or certificate found guilty of  
6 unprofessional conduct to pay to the Board all reasonable costs of investigation and prosecution  
7 of the case, including, but not limited to, attorneys' fees incurred prior to the commencement of  
8 the hearing.<sup>8</sup>

9 15. Code Section 5000.1 provides as follows: "Protection of the public shall be the  
10 highest priority for the California Board of Accountancy in exercising its licensing, regulatory,  
11 and disciplinary functions. Whenever the protection of the public is inconsistent with other  
12 interests sought to be promoted, the protection of the public shall be paramount."

### 13 **Applicable Professional Standards**

#### 14 ***Generally Accepted Auditing Standards***

15 16. Professional standards or standards of practice pertinent<sup>9</sup> to this Accusation and  
16 the audit engagements at issue include, without limitation:

17 A. Generally Accepted Auditing Standards ("GAAS") issued by the American  
18 Institute of Certified Public Accountants (AICPA). The ten generally accepted auditing  
19 standards<sup>10</sup> are discussed at some length in the Statements on Auditing Standards ("SAS"), which  
20 are codified, by "AU" number, in the AICPA's *Codification of Statements on Auditing Standards*.

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22 8. Effective January 1, 2005, all pre-hearing costs incurred subsequent to that date are  
23 eligible for reimbursement, regardless of the allegations with which they are associated. Costs  
24 incurred prior to January 1, 2005, are recoverable if they are associated with the specific  
allegations identified by Code Section 5107 prior to the January 1, 2005 amendments.

25 9. All references herein to standards and other authoritative literature are to the versions in  
26 effect at the time the audit engagements were being performed

27 10. The ten fundamental auditing standards are codified at AU § 150 and are elaborated  
28 upon throughout the Statements on Auditing Standards. Among these ten standards are three  
General standards, three standards of Fieldwork, and four Standards of Reporting, all of which  
are further described in the other SAS's.

1 Relevant professional standards, without limitation, are set forth immediately below:

2 General Standards

3 (1.) Due professional care. The third “General Standard” provides that due  
4 professional care is to be exercised in the performance of the audit and the preparation of the  
5 report. (AU § 150.02; AU § 230.01)

6 (a.) Due professional care requires that the auditor exercise  
7 professional skepticism in performing audit and review procedures and gathering and analyzing  
8 audit evidence. (AU §§ 230.07-.08)

9 (b.) “In exercising professional skepticism, the auditor should not be  
10 satisfied with less than persuasive evidence because of a belief that management is honest.” (AU  
11 § 230.09)

12 (c.) Exercise of professional skepticism requires auditors to  
13 demonstrate a questioning mind and to critically assess audit evidence. (AU § 316.13)

14 (d.) Professional skepticism is a critical component of the audit  
15 approach. (AU § 316.16 ff.)

16 Field Work Standards

17 (2.) Evidential Matter. The third “Standard of Field Work” provides that  
18 “Sufficient competent evidential matter is to be obtained through inspection, observation,  
19 inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial  
20 statements under audit.” (AU § 150.02)

21 (a.) Auditors are required obtain sufficient competent evidential matter  
22 through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an  
23 audit opinion. (AU § 326.01)

24 (b.) Evidence obtained from independent sources outside the company  
25 provides greater assurance of reliability than that secured solely within the company. (AU §  
26 326.21a)

27 (c.) Auditors may not substitute management’s representations for  
28 the application of auditing procedures necessary to afford a reasonable basis for an audit

1 opinion. (AU § 333.02)

2 (d.) AU § 339.05 states in pertinent part that “Working papers ordinarily  
3 should include documentation showing that the audit evidence obtained, the auditing procedures  
4 applied, and the testing performed have provided sufficient competent evidential matter to afford  
5 a reasonable basis for an opinion ...”.

6 Reporting Standards

7 (3.) Three of the four “Standards of Reporting” (AU § 150.02) provide  
8 as follows:

9 “1. The report shall state whether the financial statements are presented in  
10 accordance with GAAP.”

11 “3. Informative disclosures in the financial statements are to be regarded as  
12 reasonably adequate unless otherwise stated in the report.”

13 and

14 “4. The report shall contain either an expression of opinion regarding the  
15 financial statements, taken as a whole, or an assertion to the effect that an  
16 opinion cannot be expressed...”.

17 AU Section 508 provides further guidance regarding the relationship of the “fourth”  
18 reporting standard (immediately above) to the language of the auditor’s report. The auditor can  
19 determine that s/he is able to issue an audit report containing an unqualified opinion only if s/he  
20 has conducted the audit in accordance with GAAS (AU §§ 508.07). GAAS provides that if a  
21 company omits from its financial statements, including the accompanying notes, information that  
22 is required by GAAP, the auditor should express a qualified or adverse audit opinion and should  
23 provide the information in the auditor’s report (AU § 431.03). GAAS further requires auditors to  
24 read the other information in a company’s annual reports and to consider whether this other  
25 information is materially inconsistent with information in the financial statements and whether  
26 the auditors should take appropriate action to correct the inconsistency (AU §§ 550.02 & .04).

27 B. Generally Accepted Accounting Principles (“GAAP”), derived from  
28 various authoritative sources, including, without limitation, Statements and Interpretations issued  
by the Financial Accounting Standards Board (FASB).

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1 **FIRST CAUSE FOR DISCIPLINE**

2 **Imposition of Discipline, Penalty or Sanction by the SEC**  
3 **[Business and Professions Code § 5100(f)]**

4 ***Gemstar Audit Engagements and Licensee Roles***

5 17. **KPMG LLP** ("KPMG") is a Delaware limited liability partnership and a national  
6 public accounting firm with its headquarters in New York, New York. KPMG was the auditor  
7 for Gemstar-TV Guide International, Inc.<sup>11</sup> from 1993 until October 30, 2002, when Gemstar  
8 dismissed KPMG as its independent accountants.<sup>12, 13</sup> On November 22, 2002, KPMG advised  
9 Gemstar that its reports on Gemstar's financial statements for the periods ended March 31, 2000  
10 through December 31, 2001, should no longer be relied upon because Gemstar's November 15,  
11 2002 filing of a Form 10-K/A (Amendment No. 2) that restated Gemstar's consolidated financial  
12 statements, without audit, constituted an implicit withdrawal of management's representations as  
13 to the financial statements previously audited by KPMG.

14 18. **Respondent Bryan E. Palbaum** began work on the Gemstar engagement during  
15 the audit for the fiscal year ended March 31, 2000.<sup>14</sup> He was one of two KPMG co-engagement  
16 partners<sup>15</sup> for the Gemstar engagement from the June 30, 2000 review through the March 31,  
17 2002 review (a period which included two more Gemstar audits, for the FYE's ended December  
18 2000 and December 2001). While performing an in-depth review of Gemstar's March 31, 2000

19 \_\_\_\_\_  
20 11. Gemstar, based in Hollywood, Calif., publishes TV Guide magazine and licenses and  
21 sells advertising on an interactive program guide (IPG) for television that enables consumers to  
22 navigate through and select television programs.

23 12. On December 31, 2000, Gemstar changed its fiscal year end from March 31 to  
24 December 31.

25 13. KPMG performed a total of ten financial statement audits for Gemstar (for the years  
26 ended March 1993, March 1994, March 1995, March 1996, March 1997, March 1998, March  
27 1999, March 2000, December 2000, and December 2001). KPMG also reviewed Gemstar's  
28 quarterly SEC filings, up to and including the March 2002 quarterly review).

14. As previously noted, Gemstar subsequently (on December 31, 2000) changed its  
fiscal year end from March 31 to December 31.

15. The other co-engagement partner, not charged in the SEC proceeding, was Respondent  
Carroll. See paragraph 46ff, below.



1 financial statements, Respondent Palbaum reviewed the work papers supporting the auditors'  
2 conclusions on significant issues arising from the year-end financial statements. As the co-  
3 engagement partner for all periods following his in-depth review through the March 31, 2002  
4 review, Respondent Palbaum shared primary responsibility for the conduct of the reviews and  
5 audits of Gemstar's financial statements.

6 19. **Respondent John M. Wong** was the KPMG engagement partner for the Gemstar  
7 engagement for the audits of the fiscal years ended March 31, 1996 through March 31, 2000. As  
8 the engagement partner, Respondent Wong had primary responsibility for the conduct of the  
9 quarterly reviews and the audit of Gemstar's financial statements, including that for the year  
10 ended March 31, 2000. He did not participate in any audits or reviews of Gemstar's financial  
11 statements subsequent to March 31, 2000. Respondent Wong had also previously served as a  
12 manager for the Gemstar audit for the fiscal years ended March 31, 1993 through 1995.

13 20. **Respondent Kenneth B. Janeski** was the KPMG SEC reviewing partner for the  
14 Gemstar engagement from 1999 through the March 31, 2002 review. As the SEC reviewing  
15 partner, Respondent Janeski participated in planning the Gemstar engagements, consulted with  
16 other members of the audit team and reviewed the company's financial statements for compliance  
17 with professional standards and SEC rules and regulations.

18 21. **Respondent David A. Hori** was a KPMG senior manager for the Gemstar  
19 engagement from late 1999 through the March 31, 2002 review. As senior manager, Respondent  
20 Hori supervised staff in KPMG's performance of the reviews and audits of Gemstar's financial  
21 statements.

22 22. Respondent KPMG's partnership registration, and the licenses of Respondents  
23 Palbaum, Wong, Janeski, and Hori, are subject to disciplinary action under Section 5100(I)  
24 pursuant to an Order entered by the United State Securities and Exchange Commission ("SEC"  
25 or "Commission"). The above-named Respondents made Offers of Settlement to the  
26 Commission, and, which were accepted, and upon which the Order was based. The  
27 Respondents, without admitting or denying the findings therein, except as to the Commission's  
28 jurisdiction over them and the subject matter of the Commission's proceedings, consented (in a

1 settlement of the case) to the entry, effective October 20, 2004, of the Commission's *Order*  
2 *Instituting Public Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules*  
3 *of Practice, Making Findings, and Imposing Remedial Sanctions* (Admin. Proc. File No. 3-  
4 11714)(hereinafter the "Order" or Commission's Order), <sup>16</sup> attached hereto as Exhibit A, in  
5 which the Commission made findings, summarized below.

6 ***Background - Gemstar and Related Entities***

7 23. **Gemstar-TV Guide International, Inc.** is a Delaware corporation with its  
8 principal place of business in Hollywood, California. Gemstar's common stock is registered with  
9 the Commission pursuant to Section 12(g) of the Exchange Act and listed on the Nasdaq  
10 National Market System. In August and September 2002, Gemstar announced that it would  
11 restate its financial results for the year ended December 31, 2001. In addition, from November  
12 14, 2002 through March 31, 2003, Gemstar twice filed amended periodic reports to restate its  
13 financial results for 2001 and the first quarter of 2002 and restated its financial results for the  
14 second and third quarters of 2002. Also on March 31, 2003, Gemstar filed its 2003 Form 10-K  
15 to become current on its financial reporting obligations.

16 24. **Scientific-Atlanta, Inc.**, a public company, provides equipment and services to  
17 the cable television industry. Gemstar and Scientific-Atlanta were parties to a License and  
18 Settlement Agreement, which expired in July 1999 and under which Scientific-Atlanta paid fees  
19 to Gemstar in connection with Scientific-Atlanta's manufacture and sale of cable television set-  
20 top boxes. Between late 1998 and early 2001, Gemstar and Scientific-Atlanta initiated seven  
21 different lawsuits against one another relating to the purported misappropriation of each other's  
22 intellectual property. From early 2000 through early 2002, Gemstar recognized and reported, but  
23 had not received, \$113.5 million in licensing revenue from Scientific-Atlanta. In November  
24 2002, Gemstar reversed the Scientific-Atlanta licensing revenue that it had recognized.

25 25. **Time Warner, Inc.**, frequently known as AOL Time Warner, Inc. ("AOLTW"), a  
26 public company formed in connection with the January 2001 merger of America Online, Inc.

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27  
28 16. The Order is also filed as Securities Exchange Act of 1934 Rel. No. 50564; and  
Accounting and Auditing Enforcement Rel. No. 2125.

1 ("AOL") and Time Warner, Inc., operates various media businesses, including cable television  
2 systems through its Time Warner Cable ("TWC") subsidiary. Gemstar entered into an eight-year  
3 licensing agreement with AOL and received a \$23.5 million up-front non-refundable fee in May  
4 1999 which management represented was for the transfer of the license and for twelve months of  
5 technical assistance and engineering support. Gemstar recognized the \$23.5 million from May  
6 1999 through June 2000. From late 2001 through early 2002, Gemstar recognized and reported,  
7 but had not received, \$18.1 million in licensing revenue from TWC. In March 2003, Gemstar  
8 restated its recognition of the \$23.5 million up-front fee so that the fee would be recognized over  
9 the eight-year term of the agreement, and reversed the TWC licensing revenue that it had  
10 recognized.

11 26. **Fantasy Sports Properties, Inc.**, a privately owned company, creates and  
12 implements Internet-based fantasy sports games. In June 2001, Gemstar acquired Fantasy Sports'  
13 intellectual property by paying \$750,000 in cash and agreeing to run \$20 million in advertising  
14 for Fantasy Sports. During 2001, Gemstar ran advertising for Fantasy Sports and recognized and  
15 reported \$20 million in advertising revenue from Fantasy Sports. In November 2002, Gemstar  
16 reversed the Fantasy Sports advertising revenue that it had recognized.

17 27. **Motorola, Inc.**, a public company, entered into an October 2000 License and  
18 Settlement Agreement with Gemstar, under which Gemstar ran advertising for Motorola and  
19 recognized and reported a total of \$17.5 million in advertising revenue in 2001 and 2002.  
20 Gemstar reversed the recognition of this revenue in March 2003.

21 28. **Tribune Company**, a public company, operates various media businesses,  
22 including the WGN television station. In April 2001, Tribune acquired Gemstar's WGN  
23 distribution business by paying \$106 million in cash and agreeing to purchase \$100 million in  
24 advertising from Gemstar. Under this agreement, Gemstar ran advertising for Tribune and  
25 recognized and reported \$26 million in advertising revenue in 2001 and 2002. In March 2003,  
26 Gemstar reversed the recognition of the \$26 million as advertising revenue and allocated it to the  
27 sale of the WGN distribution business and interest income.

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***The KPMG Auditors' Understanding of Gemstar's Business  
and Reported Financial Results.***

29. As relevant herein, KPMG audited or reviewed Gemstar's annual and quarterly financial statements from the quarter ended September 30, 1999, through the quarter ended March 30, 2002.

A. From these audits and reviews, the KPMG auditors understood that, in the fiscal year ended March 31, 2000, virtually all of Gemstar's revenues were derived from licensing Gemstar technologies. During this period, Gemstar's primary technology was an interactive program guide ("IPG") that enabled consumers to navigate through, sort, obtain information on, and select television programs.

B. The KPMG auditors further understood that after Gemstar's July 2000 TV Guide acquisition, Gemstar divided its business into three primary sectors. The first sector was the Technology and Licensing ("Licensing") Sector, which developed and licensed Gemstar's technologies, including the IPG. Gemstar generated revenue in this sector by charging a licensing fee for the right to use the technologies. The second sector was the Interactive Platform ("Interactive") Sector, which constructed and operated the infrastructure for the delivery of IPG services and IPG and Internet advertising to consumers. Gemstar generated revenues in this sector principally by selling advertising on the IPG. The third sector was the Media and Services ("Media") Sector, which operated various media properties, including the TV Guide magazine. Gemstar generated revenues in this sector from subscription fees, advertising revenues, programming fees, and catalog sales.

C. The KPMG auditors also knew from their audits and reviews of Gemstar's financial statements that, beginning in the quarter ended September 30, 2000, Gemstar began separately reporting sector results. They also reasonably should have known that Gemstar touted the strong performance of the Licensing and Interactive Sectors; that during 2001, the Interactive Sector's financial performance was important to the securities market and to the market's valuation of Gemstar stock, even though the Interactive Sector contributed only a small percentage to Gemstar's consolidated financial results; and that Gemstar's IPG was a new and

1 untested advertising medium.

2 30. The Commission found that auditing failures on the part of KPMG and its  
3 auditors involved improper accounting and improper disclosures for both licensing and  
4 advertising revenue, as summarized below:

5 Licensing Revenue

6 A. Improper Accounting: During the relevant period, Gemstar recognized  
7 material amounts of licensing revenue, involving America Online, Inc. ("AOL") (\$23.5 million);  
8 Scientific-Atlanta, Inc. (\$113.5 million in revenue); and Time Warner Cable ("TWC") (\$18.1  
9 million).

10 KPMG and its auditors also knew or reasonably should have known that Gemstar  
11 was recognizing additional material amounts of IPG licensing revenue from AOL over a 12-  
12 month period, even though the contract had an eight-year term and Gemstar had not produced  
13 sufficient evidence to support its recognition of the revenue over 12 months. Gemstar ultimately  
14 reversed the improperly recognized revenue.

15 KPMG and its auditors knew or reasonably should have known that Gemstar was  
16 recognizing material amounts of IPG licensing revenues from Scientific-Atlanta and TWC even  
17 though Gemstar did not have an arrangement or current written contract with Scientific-Atlanta  
18 and TWC, that Gemstar had not received any of the recognized revenue, and that Gemstar's  
19 receipt of the revenue was contingent on Gemstar's negotiating a contract with, or settling or  
20 prevailing in litigation against, the purported licensee.

21 B. Improper Disclosure: Respondents reasonably should have known that  
22 Gemstar's disclosed revenue recognitions policies in Forms 10-K, as relating to the AOL,  
23 Scientific-Atlanta, and TWC revenue, did not comply with GAAP disclosure requirements. The  
24 auditors reasonably should have known that Gemstar's disclosure of the AOL IPG agreement  
25 was inconsistent with Gemstar's accounting for the AOL up-front fee and did not conform to  
26 GAAP, and that Gemstar's disclosed licensing revenue recognition policy was inadequate under  
27 GAAP to describe Gemstar's actual recognition of the contingent Scientific-Atlanta and TWC  
28 revenue.

Advertising Revenue

C. Improper Accounting. During the relevant period, Gemstar recognized material amounts of IPG advertising revenue from multi-element transactions with Motorola (\$17.5 million) and Tribune (\$17 million), from a non-monetary transaction with Fantasy Sports (\$20 million in revenue), and from certain print advertisers. KPMG and its auditors knew or reasonably should have known that Gemstar was improperly recognizing material amounts of IPG advertising revenue from certain transactions even though Gemstar had provided insufficient evidence of the IPG advertising's fair value as required by generally accepted accounting principles (GAAP). Gemstar ultimately reversed the improperly recognized revenue.

In the last two quarters of 2001, Gemstar gave advertisers that had already committed to purchase a total of \$5.6 million in print advertising an equal amount of IPG advertising for free. Gemstar, however, recognized and reported the \$5.6 million in revenue in the Interactive Sector and not as print advertising revenue in the Media Sector. This revenue was material to Gemstar's separately reported Interactive Sector financial results.

During the September 30, 2001 review, the auditors received information from a TV Guide controller concerning the allocation of IPG revenue, but despite this information, relied on an assurance from a Gemstar accountant that the amount of multi-platform advertising revenue was not significant in 2001 and that Gemstar was developing a policy for proper recognition of such revenue in the future.

31. Improper Disclosure: KPMG and its auditors knew or reasonably should have known that Gemstar's disclosure in its public filings regarding its Interactive Sector revenue was inconsistent with its accounting for those transactions. Further, in light of their knowledge of certain Motorola and Tribune transactions, the auditors reasonably should have known that Gemstar's disclosure was inconsistent with its accounting for the transactions.

***KPMG's Policy Regarding Possible Restatements***

32. KPMG's Consultation Procedures. The Commission found that:

A. In mid-August 2002, as part of Gemstar's audit committee's investigation into potential restatements of Gemstar's financial statements, certain information came to light

1 that the local KPMG audit engagement team did not convey to KPMG's national office. This  
2 information included evidence indicating that senior Gemstar management may have been  
3 involved in an intentional mis-reporting of IPG advertising revenue and that Gemstar did not  
4 have sufficient evidence to recognize other IPG advertising revenue.

5 B. KPMG did not have a policy that required that a local engagement team  
6 consult with the national office on all new significant issues that had come to the local  
7 engagement team's attention. Such a consultation should have led KPMG to consider the  
8 additional evidence that came to light during the audit committee's investigation and could have  
9 led KPMG to a more prompt decision to withdraw its previously issued audit report on Gemstar's  
10 2001 financial statements. KPMG did not take that step until November 22, 2002.

11 **SEC Findings of Improper Professional Conduct/SEC Rule 102(e)**

12 33. The SEC's administrative Order finds that :

13 A. From September 1999 through March 2002, the (SEC) respondents'  
14 conduct resulted in repeated audit failures in connection with KPMG's audits of Gemstar's  
15 (Gemstar-TV Guide International, Inc.) financial statements.

16 B. The (SEC) respondents reasonably should have known that Gemstar  
17 improperly recognized and reported in its public filings material amounts of licensing and  
18 advertising revenue. The (SEC) respondents reasonably should have known that Gemstar's  
19 recognition of the revenue was not in accordance with GAAP.

20 C. KPMG's auditors (including the individual Respondents named herein)  
21 repeatedly relied on Gemstar management's representations even when those representations  
22 were contradicted by their audit work. The auditors thus failed to abide by one of the core  
23 principles of public accounting -- to exercise professional skepticism and due professional care.

24 34. The SEC found that KPMG and its auditors committed improper professional  
25 conduct (repeated instances of unreasonable conduct) in violation of the Commission's Rule  
26 102(e)(1)(iii)(B)(2), in that they acted unreasonably in failing to require Gemstar to comply with  
27 GAAP, and in failing to comply with GAAS during their audits and reviews of Gemstar's  
28 financial statements (AU §§431.03; AU §§550.02 & .04).

1           A.     The Commission found that in auditing and reviewing Gemstar's financial  
2 statements, certain of the KPMG auditors<sup>17</sup> and KPMG acted unreasonably in failing to exercise  
3 due professional care and skepticism, failing to obtain sufficient competent evidential matter, and  
4 substituting management's representations for competent evidential matter.

5           B.     The Commission found that, with respect to Gemstar's financial  
6 statements, certain of the KPMG auditors<sup>18</sup> and KPMG unreasonably failed to take appropriate  
7 action as required by AU §431.03 (requirements for auditor's opinion and report) and AU  
8 §§550.02 & .04 (requirements re: materially inconsistent financial information) in connection  
9 with Gemstar's financial statements.

10          C.     The Commission found that, despite indications of Gemstar's improper  
11 accounting and disclosure, Messrs. Wong, Palbaum, Janeski and Hori caused unqualified audit  
12 reports to be issued, representing that KPMG had conducted its audits in accordance with  
13 generally accepted auditing standards (GAAS) and that Gemstar's financial statements fairly  
14 presented its financial results in conformity with GAAP. They reasonably should have known  
15 that Gemstar's financial statements did not conform to GAAP and that they did not conduct their  
16 audits in accordance with GAAS. In reaching their conclusions, the auditors failed to observe  
17 AU Sections 508.04 & .07, in that they unreasonably relied on representations by Gemstar's  
18 management and its inside or outside legal counsel or decided that the unsupported revenues  
19 were immaterial to Gemstar's financial statements. The auditors' reliance on these  
20 representations was unreasonable because the representations were contradicted by other  
21 evidence and contained qualifications that called into question their reliability. The auditors'  
22 materiality determinations were unreasonable in that they were based on a quantitative analysis  
23 and failed to consider whether the revenues at issue were qualitatively material. The auditors'  
24 conduct caused KPMG to render its audit reports containing unqualified opinions that  
25 inaccurately stated that Gemstar's financial statements conformed to GAAP and that they had  
26 conducted their audits in accordance with GAAS.

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28       17. See paragraph 35.

      18. See paragraph 35.



1           35. In addition to the findings immediately above, with respect to Respondents  
2 KPMG, Janeski, Wong, Hori and Palbaum, the Commission's findings<sup>19</sup> specifically did not  
3 include charges against:

4           A. Respondent Janeski:

5                   (1) with respect to the review of the AOL IPG agreement and the up-  
6 front non-refundable fee and the auditors' resulting failure to take appropriate action in light of  
7 Gemstar's having no stated policy for the recognition of revenue for technical assistance and  
8 engineering support; and

9                   (2) relating to the fair value of the IPG advertising and improper  
10 revenue recognition as to Tribune.

11           B. Respondent Wong with respect to:

12                   (1) the appropriate determination regarding the finality of the  
13 arrangement and its relationship to the TWC revenue recognition issue;

14                   (2) the first quarter 2001 Fantasy Sports revenue recognition issue  
15 (regarding an appropriate determination of a final arrangement and reasonable assurance of  
16 collectibility);

17                   (3) the improper revenue recognition as to Tribune, Motorola and  
18 Fantasy Sports;

19                   (4) the inadequacy of Gemstar's disclosed licensing revenue  
20 recognition policy under GAAP and the auditors' resulting failure to take appropriate action  
21 regarding that revenue recognition policy in connection with TWC.

22           C. Respondents Wong and Janeski with respect to the specific failure to  
23 conclude that Gemstar had improperly allocated the print advertising revenue to the Interactive  
24 Sector instead of the Media Sector;

25           D. Respondent Wong and Respondent Janeski (only as to Tribune) with  
26 respect to evidence that Gemstar's disclosure regarding the Interactive Sector financial results  
27 and the reasons therefore were inconsistent with Gemstar's recognition of IPG revenue from the  
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19. As already stated, the SEC did not charge Respondent Carroll in its proceeding.

1 multi-element Motorola and Tribune transactions, and from the resulting failure to take  
2 appropriate action in light of these issues regarding the Motorola and Tribune revenue.

3 *The Commission's Sanctions*

4 36. Respondent KPMG LLP. Based upon its findings (summarized above), the  
5 Commission found that KPMG engaged in improper professional conduct within the meaning of  
6 Rule 102(e)(1)(ii) of the Commission's Rules of Practice. The Commission found that KPMG  
7 engaged in repeated instances of unreasonable conduct, each resulting in a violation of applicable  
8 professional standards. KPMG made an Offer of Settlement, including certain undertakings. In  
9 determining whether to accept KPMG's offer, the SEC considered KPMG's offered undertakings  
10 and deemed it appropriate to impose the sanction of censure upon KPMG.<sup>20</sup>

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13 20. Under the terms of the Order, KPMG undertook and agreed to do the following:

- 14 1. Pay \$10 million to harmed Gemstar shareholders.
- 15 2. Conduct (a) **training** for its partners and managers with respect to (i) qualitative materiality; (ii)  
16 accounting for multi-element transactions; and (iii) consideration of appropriate disclosure related to  
17 complex accounting issues, which are defined as accounting issues about which an engagement team  
18 specifically consulted with the Department of Professional Practice, local Professional Practice Partner,  
19 or the SEC Reviewing Partner; by June 30, 2005, KPMG was to certify in writing to the Commission  
20 that such training had occurred; and (b) continuing **training** to its audit personnel on such topics, as  
21 appropriate.
- 22 3. **Adopt a policy** that (1) requires engagement teams to (a) **consult** with the Department of  
23 Professional Practice whenever (i) a registrant informs the engagement team that it is considering  
24 restating previously issued financial statements (for reasons other than due to the adoption of new  
25 accounting pronouncements, a change in accounting principle or the application of an accounting  
26 principle that requires or permits retroactive application) or (ii) the engagement team independently is  
27 considering whether to advise the registrant that previously issued financial statements should be  
28 restated (for reasons other than due to the adoption of new accounting pronouncements, a change in  
accounting principle or the application of an accounting principle that requires or permits retroactive  
application); (b) to **include** in such consultation all significant new information related to the  
previously issued financial statements not known by the engagement team at the time the audit report  
was issued and not limit its consultation to the initial issue or issues which may have led to a  
consideration of a possible restatement; and (c) **document its communication and consultation** with  
the Department of Professional Practice, which documentation shall be included by the engagement  
team in KPMG's work papers for the client and a copy sent to the Department of Professional Practice;  
and (2) requires the Department of Professional Practice, upon a determination, either by the issuer of  
the financial statements or by KPMG, that there is a likely material error in the previously issued  
financial statements, to review the memorandum previously prepared by the engagement team  
documenting significant issues that arose during the audits of the financial statements that may be  
restated (currently the Significant Issues and Decisions Document, or its functional equivalent). By  
January 31, 2005, KPMG was to certify in writing to the Commission that such a policy has been  
established and implemented.

1           37.   Respondent Palbaum. Based upon its findings (summarized above), the  
2 Commission found that Respondent Palbaum engaged in improper professional conduct pursuant  
3 to Rule 102(e)(1)(ii) of the Commission's Rules of Practice, specifically, that he engaged in  
4 repeated instances of unreasonable conduct, each resulting in a violation of applicable  
5 professional standards. Respondent Palbaum was denied the privilege of appearing or practicing  
6 before the Commission as an accountant. After three years from the effective date (October 20,  
7 2004) of the SEC's Order, that is, after October 20, 2007, he may request that the Commission  
8 consider his reinstatement by submitting an application, subject to terms and conditions specified  
9 in the Order.

10           38.   Respondent Wong. Based upon its findings (summarized above), the  
11 Commission found that Respondent Wong engaged in improper professional conduct pursuant to  
12 Rule 102(e)(1)(ii) of the Commission's Rules of Practice, specifically, that he engaged in  
13 repeated instances of unreasonable conduct, each resulting in a violation of applicable  
14 professional standards. Respondent Wong was denied the privilege of appearing or practicing  
15 before the Commission as an accountant. After one year from the effective date of the SEC's  
16 Order, that is, after October 20, 2005, he may request that the Commission consider his  
17 reinstatement by submitting an application, subject to terms and conditions specified in the Order

18           39.   Respondent Janeski. Based upon its findings (summarized above), the  
19 Commission found that Respondent Janeski engaged in improper professional conduct pursuant  
20 to Rule 102(e)(1)(ii) of the Commission's Rules of Practice, specifically, that he engaged in  
21 repeated instances of unreasonable conduct, each resulting in a violation of applicable  
22 professional standards. Respondent Janeski was denied the privilege of appearing or practicing  
23 before the Commission as an accountant. After one year from the effective date of the SEC's  
24 Order, that is, after October 20, 2005, he may request that the Commission consider his  
25 reinstatement by submitting an application, subject to terms and conditions specified in the  
26 Order.

27           40.   Respondent Hori. Based upon its findings (summarized above), the  
28 Commission found that Respondent Hori engaged in improper professional conduct pursuant to

1 Rule 102(e)(1)(ii) of the Commission's Rules of Practice, specifically, that he engaged in  
2 repeated instances of unreasonable conduct, each resulting in a violation of applicable  
3 professional standards. Respondent Hori was denied the privilege of appearing or practicing  
4 before the Commission as an accountant. After eighteen months from the effective date of the  
5 SEC's Order, that is, after April 20, 2006, he may request that the Commission consider his  
6 reinstatement by submitting an application, subject to terms and conditions specified in the  
7 Order.

8 41. As set forth above, the Commission's Decision and Order constitutes the  
9 imposition of a penalty, sanction, or discipline on the respective Respondents by the United  
10 States Securities and Exchange Commission within the meaning of Code Section 5100(I),  
11 establishing cause for discipline of Respondent KPMG LLP's partnership registration under  
12 Code Section 5101 and cause for discipline of the licenses of Respondents Palbaum, Wong,  
13 Janeski, and Hori under Code Section 5100.

## 14 15 **SECOND CAUSE FOR DISCIPLINE**

### 16 **Suspension of Right to Practice Before a Governmental Body or Agency** 17 **[Business and Professions Code § 5100(h)]**

18 42. Complainant realleges paragraphs 17 through 35 and 37 through 40 above, and  
19 incorporates them herein by reference as if fully set forth at this point.

20 43. The Certified Public Accountant licenses of Respondents Palbaum, Wong,  
21 Janeski, and Hori are each subject to disciplinary action, in that the Commission's Order  
22 constitutes the suspension of their respective rights to practice before a governmental body or  
23 agency within the meaning of Code Section 5100(h), establishing cause for discipline of the  
24 respective individual licenses under Code Section 5100.

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1 **THIRD CAUSE FOR DISCIPLINE**

2 **Failure to Observe Professional Standards in Performance of Audits**  
3 **[Board Rule 58/Bus. & Prof. Code § 5100(g)]**

4 44. Complainant realleges paragraphs 17 through 21 and 23 through 35, above, and  
5 incorporates them herein by reference as if fully set forth at this point.

6 45. **Respondent Roland William (“Bill”) Carroll** began work on the Gemstar  
7 engagement during the audit for the fiscal year ended March 31, 2000, providing advice and  
8 consultation to the engagement partner, Respondent Wong. He became the KPMG co-  
9 engagement partner (with Respondent Palbaum) for the Gemstar engagement from the June 30,  
10 2000 review through the March 31, 2002 review. As co-engagement partner, Respondent shared  
11 responsibility with Palbaum. In addition, Respondent Carroll served as a senior SEC reviewing  
12 partner at KPMG and was the Professional Practice Partner, in charge of technical accounting  
13 and auditing issues, for the Orange County KPMG office during a time period relevant herein.  
14 He was the office liaison with KPMG’s Department of Professional Practice Assurance (“DPP”).

15 46. Incorporating herein the matters alleged in paragraphs 44 and 45, it is alleged that  
16 the Respondents herein failed to comply with GAAS and GAAP in their audit engagements and  
17 reviews of Gemstar’s financial statements, in violation of Board Rule 58, which requires Board  
18 licensees to observe professional standards. The partnership license of KPMG and the Certified  
19 Public Accountant licenses of Respondents Palbaum, Wong, Janeski, Hori, and Carroll are each  
20 subject to disciplinary action in that their failure to comply with GAAS and to require their client  
21 to comply with GAAP, as described above, constitutes unprofessional conduct, that is, the failure  
22 to comply with applicable professional regulations, within the meaning of Board Rule 58,  
23 establishing cause for discipline of KPMG’s license under Code Sections 5100(g) and 5101, and  
24 cause for discipline of the respective individual licenses under Code Sections 5100(g) and 5100.

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1 **FOURTH CAUSE FOR DISCIPLINE**

2 **Auditor's Report Violations**  
3 **[Bus. & Prof. Code § 5062/Code § 5100(g)]**

4 47. Complainant realleges paragraphs 17 through 21, 23 through 35, and 45, above,  
5 and incorporates them herein by reference as if fully set forth at this point.

6 48. The certifications, in KPMG's audit reports in the respective years, by its auditors,  
7 that KPMG had conducted its audits of Gemstar's financial statements according to GAAS and  
8 that Gemstar's financial statements were fairly presented according to GAAP were contrary to  
9 fact and were not supported by KPMG's auditors' procedures. KPMG's auditors caused the  
10 issuance of the KPMG report in the absence of compliance with professional standards.

11 49. Incorporating by reference the matters alleged in paragraphs 48 and 49, cause for  
12 discipline of Respondent Palbaum's license is established under Code Section 5062, in  
13 conjunction with Code Section 5100(g), for his failures in his role as co-engagement partner with  
14 respect to the issuance of the December 2000 and December 2001 Gemstar audit reports.

15 50. Incorporating by reference the matters alleged in paragraphs 48 and 49, cause for  
16 discipline of Respondent Carroll's license is established under Code Section 5062, in conjunction  
17 with Code Section 5100(g), for his failures in his role as co-engagement partner with respect to  
18 the issuance of the December 2000 and December 2001 Gemstar audit reports.

19 51. Incorporating by reference the matters alleged in paragraphs 48 and 49, cause for  
20 discipline of Respondent Janeski's license is established under Code Section 5062, in  
21 conjunction with Code Section 5100(g), for his conduct with respect to his role as SEC reviewing  
22 partner in connection with the issuance of the March 2000, December 2000, and December 2001  
23 Gemstar audit reports.

24 52. Incorporating by reference the matters alleged in paragraphs 48 and 49, cause for  
25 discipline of Respondent Wong's license is established under Code Section 5062, in conjunction  
26 with Code Section 5100(g), for his conduct with respect to the issuance of the March 2000  
27 Gemstar audit report.

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1 **OTHER MATTERS**

2 **Disciplinary Considerations**

3 53. The following matters are pled in aggravation and mitigation of penalty as  
4 applicable to KPMG's license:

5 A. The firm's registration was disciplined in 2002 by the Board (see  
6 paragraph 3 above) for violations of auditing standards (which occurred in audit engagements for  
7 fiscal years ending in 1992, 1993, and 1994).

8 B. Gemstar was a long-time client of KPMG and the misconduct spanned  
9 several audit reports and reviews. The violations occurred over a period of several audit  
10 engagements and reviews and involved several KPMG personnel, as well as a weakness in  
11 KPMG procedures regarding consultation within the firm on restatements. KPMG resolved the  
12 matter with the SEC, which accepted undertakings proposed by KPMG in its Offer of Settlement.

13 C. The failures to comply with GAAS and GAAP resulted in misstated  
14 financial statements. There was significant actual consumer harm, which is being redressed in  
15 part by KPMG's contribution of \$10 million toward restitution to shareholders (pursuant to its  
16 undertaking as set forth in the SEC Order).

17 54. The following matters are pled in aggravation and mitigation of penalty as  
18 applicable to the licenses of Respondents Palbaum, Wong, Janeski and Carroll:

19 A. Respondents Palbaum, Wong, Janeski and Carroll are experienced  
20 auditors, were partners of the firm, and are either technical experts or had technical expertise  
21 available to them.

22 B. The licensees were each involved in several reviews and/or audits of  
23 Gemstar's financial statements from the mid-1990's forward. The failures to comply with GAAS  
24 and GAAP resulted in misstated financial statements. There was significant actual consumer  
25 harm (which is being redressed in part by KPMG's contribution of \$10 million toward restitution  
26 per the SEC Order).

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1 C. Respondent Hori functioned at the “manager” level and did not have  
2 ultimate responsibility for issuing the reports on the financial statements.

3 D. None of the individual licensees has a record of prior discipline with the  
4 Board.

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6 **Cost Recovery**

7 55. Pursuant to Code Section 5107, it is requested that the administrative law judge,  
8 as part of the proposed decision in this proceeding, direct Respondents to pay to the Board all  
9 reasonable costs of investigation and prosecution incurred in this case subsequent to January 1,  
10 2005, including, but not limited to, attorneys' fees.

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12 **PRAYER**

13 WHEREFORE, Complainant requests that a hearing be held on the matters herein  
14 alleged, and that following the hearing, the California Board of Accountancy issue a decision:

15 1. Revoking, suspending or otherwise imposing discipline upon Certified Public  
16 Accountant Partnership Registration No. PAR 157, issued to KPMG LLP;

17 2. Revoking, suspending or otherwise imposing discipline upon Certified Public  
18 Accountant Certificate Number CPA 51655, issued to Bryan E. Palbaum;

19 3. Revoking, suspending or otherwise imposing discipline upon Certified Public  
20 Accountant Certificate Number CPA 45405, issued to John M. Wong;

21 4. Revoking, suspending or otherwise imposing discipline upon Certified Public  
22 Accountant Certificate Number CPA 20116, issued to Kenneth B. Janeski;

23 5. Revoking, suspending or otherwise imposing discipline upon Certified Public  
24 Accountant Certificate Number CPA 68236, issued to David A. Hori;

25 6. Revoking, suspending or otherwise imposing discipline upon Certified Public  
26 Accountant Certificate Number CPA 14338, issued to Roland William (“Bill”) Carroll, Jr.

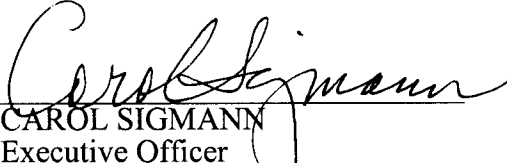
27 7. Ordering KPMG and the individual Respondents to pay the California Board of  
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1 Accountancy the reasonable costs of the investigation and enforcement of this case, pursuant to  
2 Business and Professions Code Section 5107; and

3 8. Taking such other further action as may be deemed proper.

4 DATED: March 9, 2005.

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7 CAROL SIGMANN  
8 Executive Officer  
9 California Board of Accountancy  
10 Department of Consumer Affairs  
11 State of California  
12 Complainant  
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